Volume 22, Number 24

December 11, 2013

The Liscio Report

On the Economy

For John Liscio 1949-2000

Sustainable improvement?

• confusion giving way to, maybe, some growing confidence?

• JOLTS, BED: continued modest improvement

• financial accounts (aka flow of funds): even Uncle Sam is sorta deleveraging…

• …but households are gingerly borrowing some again

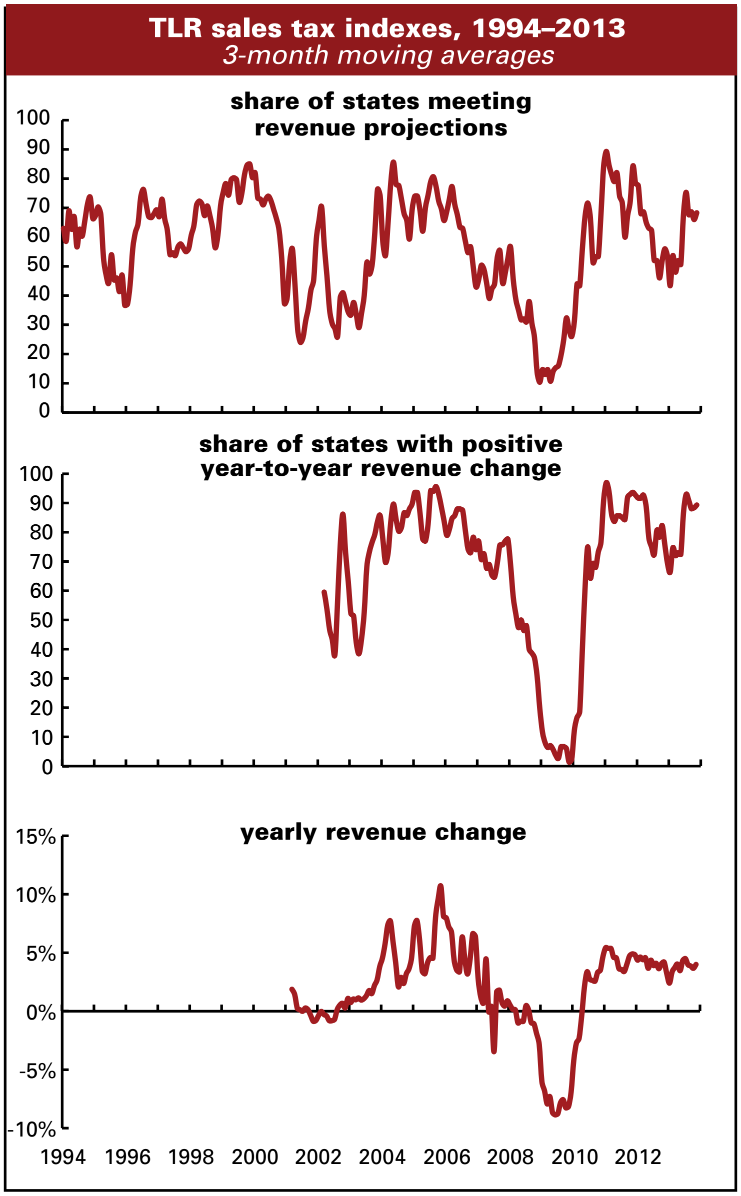
In November, 71% of the states in our survey met or exceeded their forecasted sales tax collections, up from 60% in October, and 90% reported growth over the year, pretty much even with October's 93%. The average over-the-year rate of change regained the ground it lost in October, rising to 4.7% from October's 3.2%, and the margin from forecast moved back into the positive column, +1%, after falling below, -0.5%, in October.

In general, our state tax contacts are encouraged by recent collections. Part of that is a sigh of relief that the government shut-down—remember that?—didn't cause the kind of damage some feared. But it's also receipts themselves. We show the three-month averages on p. 2, but there have been some worrisome months within that more gentle line, and it is encouraging to our index back in a healthy range.

There was, again this month, significant variation around the country. One state recovering from a housing bubble had strong withheld receipts, and weak sales receipts, another reported the opposite. Another, that does not collect withheld taxes, is beating estimates for sales receipts, and reports a rebound in state-specific consumer confidence, following a pronounced dip in October. But our contact is concerned that housing starts may be leveling off.

Our contact in one of the large Midwestern manufacturing states admits to feeling "confused" about the economy, and notes that the data support that feeling these days. He's annoyed by everything that isn't a decline being reported as a "rocket-ship upward," and is fretting about detail in the consumer confidence series. But receipts kn his state suggest stability, and with neighboring states currently reporting slightly stronger sales tax collections, and slightly weaker withheld collections, the Midwest continues to be a bright spot in our survey.

Last month we heard a contact argue for raising forecasts, and this month a contact on the east coast made a similar case. He believes a few more months of receipts in the current range will drive their forecasts up significantly. But since we've been here before, and many times at that, his department is holding off on making that official until they see a few more "strong-ish" months. And that's really the hurdle for the whole country: since the recovery began more than 4 years ago we have seldom heard any state tax official report receipts as either strong or typical of a recovery. It's generally, "Good news? Well, it's not bad news, let's put it that way."



Something has changed in the tenor of our surveys, and although it has not been enough to draw confident statements of strength, or upward revisions to current forecasts, it is encouraging that a handful of the officials looking at revenue flows are wondering if the improvement may be becoming sustainable.

BED, JOLTS

Tuesday morning brought the release of two data series beloved of labor market connoisseurs—Business Employment Dynamics (BED) for the first quarter of 2013, and the Job Openings and Labor Turnover Survey (JOLTS) for October.

Unfortunately, one can't say much about the BED release. A number of workers who were previously classified as home health care workers and therefore outside the scope of the survey's universe have been brought into it, which resulted in an artificial inflation of the employment and establishment numbers, making quarter-to-quarter comparisons impossible. There was a decline in gross job losses, however, to 5.6% of employment, tying the record low since the recovery began in 2009. But we won't be able to say anything about gross job gains, or the trend in business start-ups (which, remember, has been depressed, and a crucial factor in slow employment growth), for another three months.

The JOLTS data show continued improvement in the labor market in October. Hires fell 0.1 point from September to 3.3% of employment, but the number of separations fell by 0.2 point to 3.1%, making for an 0.2% gain in employment. The private sector did better, with a net gain of 0.3%—but mainly because separations fell by 0.3 point. Hires were off 0.1 point. Openings were unchanged at 2.8% of employment overall, and 3.0% for the private sector (at the high end of recent experience). The number of unemployed per opening remained at 2.9—down by more than half from the recession peak, but still close to twice the mid-2000s average.

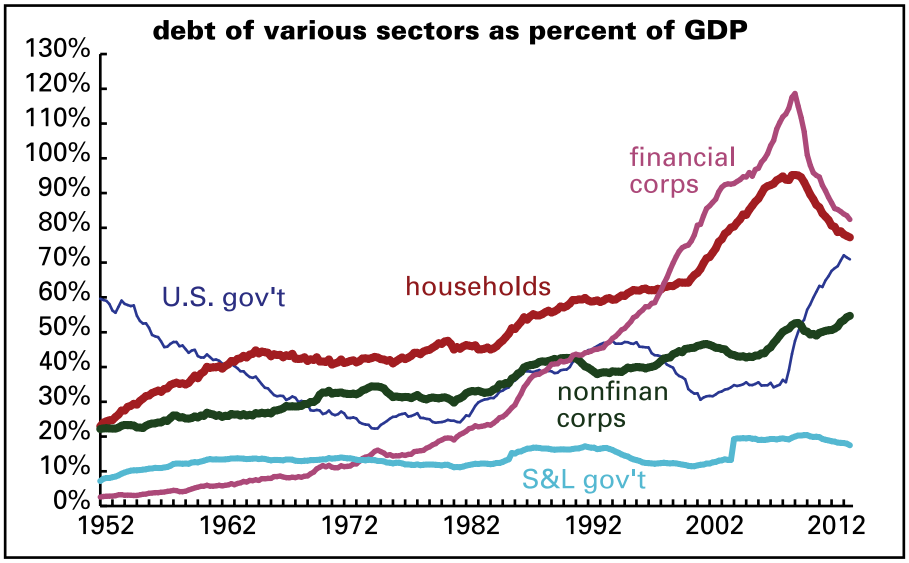
So, gradually improving, but nothing gangbusters.

flow of funds

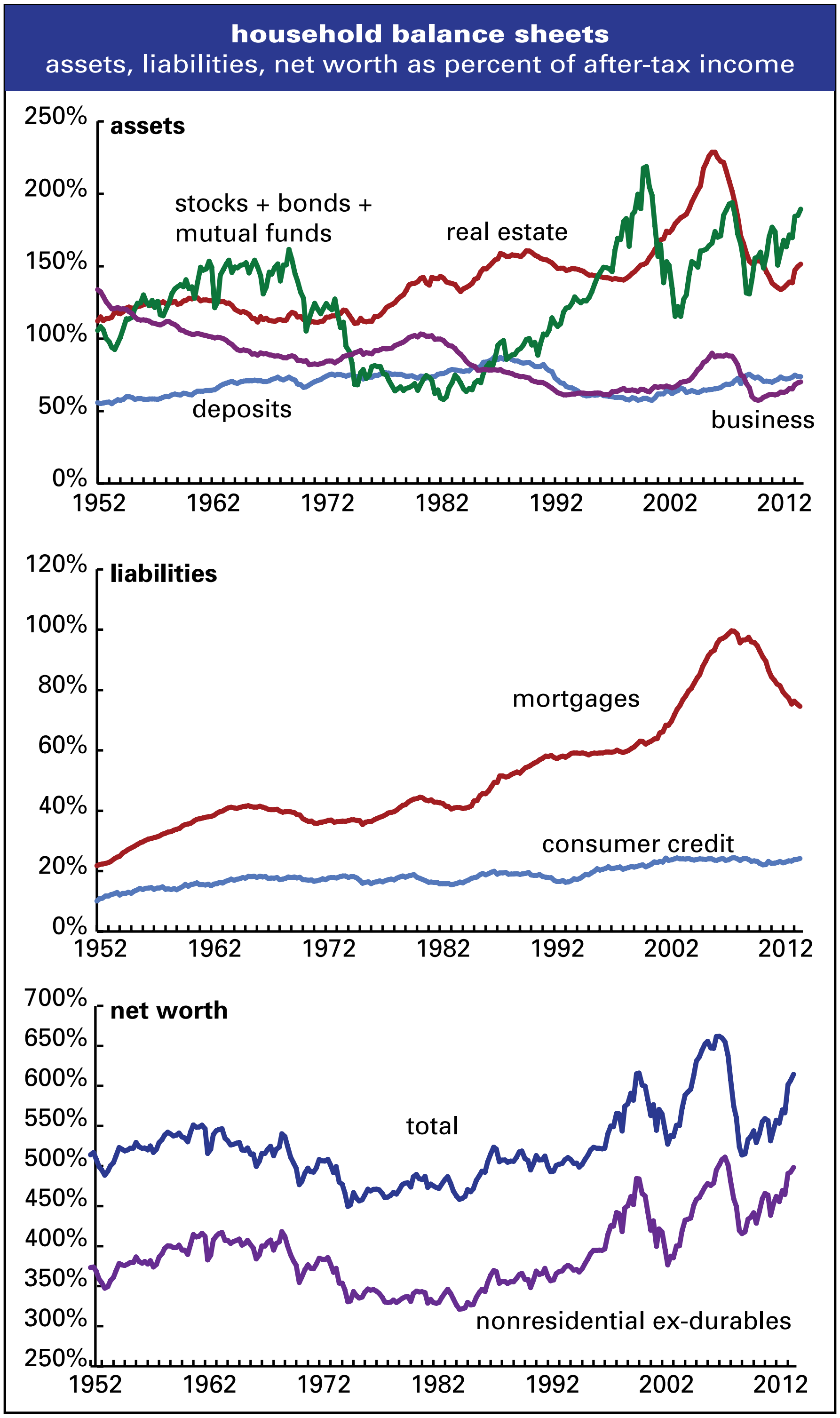
Old habits die hard: we're still calling the Fed's quarterly release the flow of funds, even though it's been officially renamed the Financial Accounts of the U.S. "Flow of funds" is snappier and nicely descriptive. Here's an overview of what happened in the third quarter of 2013.

debt by sector

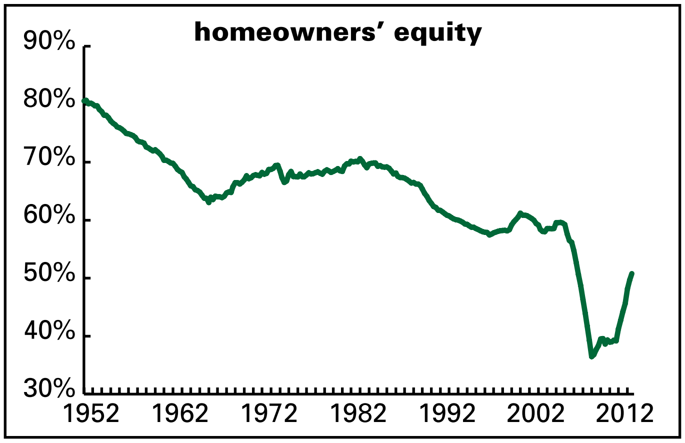
Although there was some pickup in household borrowing, it was modest, and most sectors continued deleveraging. Total credit market debt fell from 346% of GDP to 344%. As the graph at right hows, all major sectors except nonfinancial corporations showed a decline in their debt/GDP ratios—even Uncle Sam, whose ratio was down for the second consecutive quarter. (Of course, the ratio has doubled over the last five years, but that's getting to be old news. The sequester and other budget deals have kept a lid on spending, and recovery has brought in higher revenues.) The household debt ratio is back to 2003 levels, something it would have been impossible to imagine in 2007. Financial corporations' debt is back to 2001's ratio.



An exception is nonfinancial corporations, whose debts continue in a long uptrend—

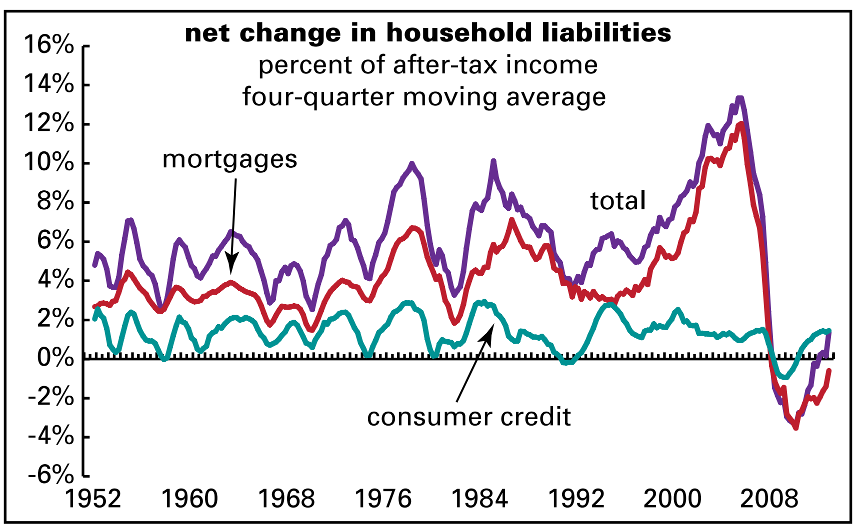

household balance sheets
assets, liabilities, net worth as percent of after-tax income
assets
250%
200%
150%
100%
50%
0%
stocks + bonds +
mutual funds
real estate
deposits
business
1952
1962
1972
1982
1992
2002
2012
liabilities
120%
100%
80%
60%
40%
20%
0%
mortgages
consumer credit
1952
1962
1972
1982
1992
2002
2012
net worth
700%
650%
600%
550%
500%
450%
400%
350%
300%
250%
total
nonresidential ex-durables
1952
1962
1972
1982
1992
2002
2012

it's almost 10 points above where it was on the cusp of the Great Recession. It seems odd to worry about overleveraging while deleveraging continues, but you have to wonder if corporations are getting carried away. Although interest rates are likely to stay low for some time, they won't stay this low forever, and rolling over that much debt in a rising rate environment could get interesting.



households

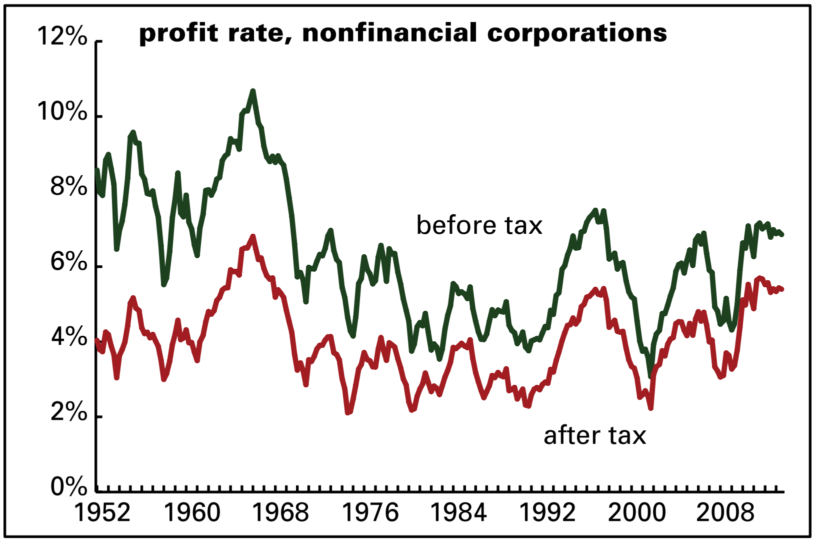
Household balance sheets improved nicely in the third quarter. (See graphs, p. 4.) Assets rose to 724% of after-tax income, their highest level in five years, with both housing and financial assets contributing to the rise. And liabilities fell to 109% of after-tax income. The rise in assets and decline in liabilities pushed up net worth from 607% of after-tax income in the second quarter to 615% in the third.



The bottom graph on p. 4 shows two definitions of net worth—total and nonresidential excluding durables. (The Fed counts durable goods as household assets, but since they're usually nonliquid, depreciate rapidly, and produce no income, we prefer to subtract them from the net worth calculations.) The "total" line actually corresponds roughly to the 95th percentile of the wealth distribution, since the ownership of financial assets is so upwardly skewed. The nonres ex-durables concept offers a much better picture of the "average" household—and it looks to have largely recovered from the recession-induced collapse.

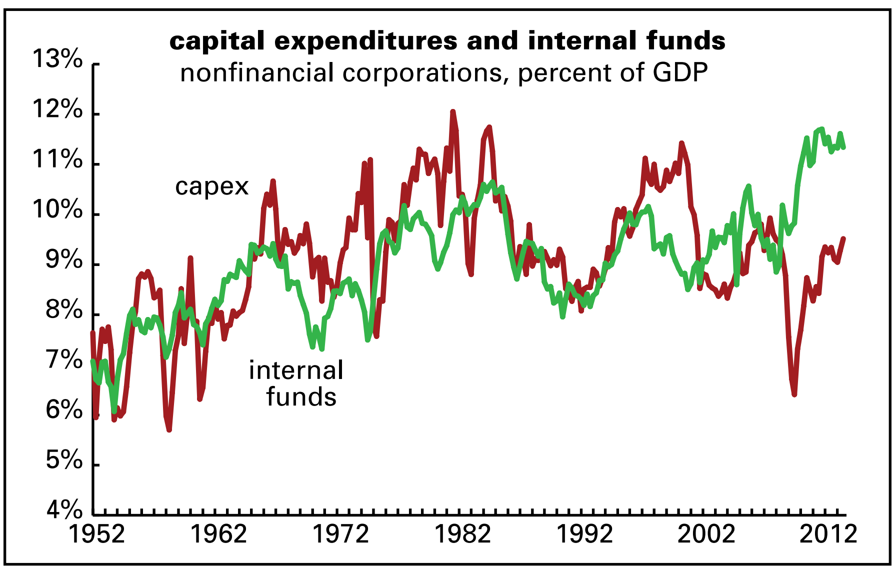
And, as the graph above shows, homeowners' equity has recovered markedly, after having fallen through most of the housing boom and subsequent bust. It broke above 50% for the first time since late 2007. (It's rather amazing that it fell by about 10 points during the bubble, as debt increased far more rapidly than house prices.)

And as the lower graph shows, households are borrowing again, though gingerly. Mortgage debt increased by 0.7% of after-tax income, its first increase since early 2009, though that's a tenth the rate it was rising in 2007. Consumer credit increased by 1.4% of after-tax income, the same as the third quarter, and about the rate of increase we've seen over the last couple of years. That coincidentally is the average rate of increase in consumer credit since the quarterly flow of funds numbers began in 1952—so while we're not yet at the boomy over-2% rate of increase, we're seeing decent credit growth. Not in mortgages, yet, though, which are only just crossing the zero line.



nonfinancial business

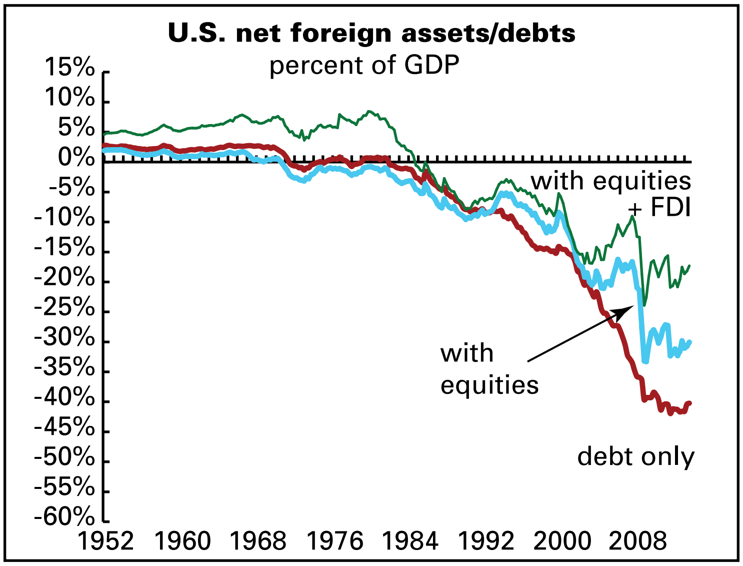
Corporate America remains in fine fettle, aside from that debt blemish perhaps. Profitability (defined as profits from the national income accounts divided by the Fed's estimate of the tangible capital stock—see graph, above) has been flat at a fairly high level for the last year or so. It's off its 2011 peak, but not by much. We've found this measure of profitability to be a long leading indicator; it suggests a maturing expansion, but one which still has a year or two to run.



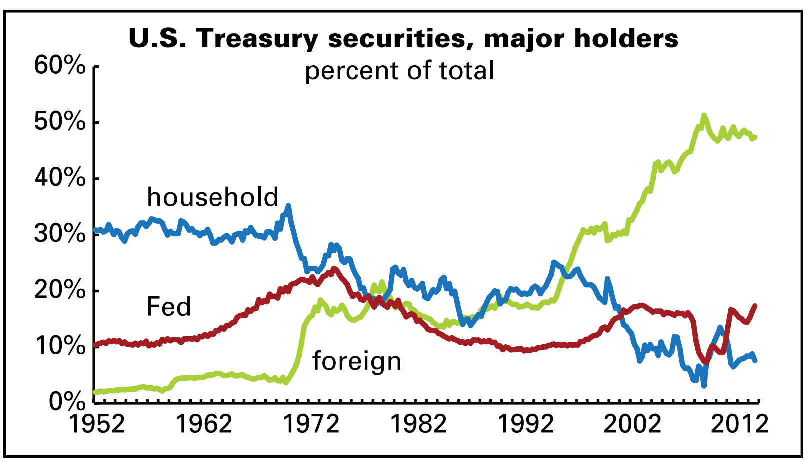
And, as the lower graph shows, cash flow greatly exceeds capital spending. The gap narrowed some in the quarter, as internal funds fell from 11.6% of GDP to 11.3%, and capex rose from 9.3% of GDP to 9.5%. But the gap, aka free cash flow, remained at 1.8% of GDP. Its 1952–2007 average was -0.3%. Corporations are generating plenty of cash, but they're not spending it lavishly on investment or employees. They are, however, continuing to shovel vast pots of it out to their shareholders, via takeovers, buybacks, and traditional dividends. Such transfers to shareholders took up just under half of internal funds, or 5.6% of GDP. Those figures are about twice their long-term averages. They're good news for the stock market, but probably not for long-term prosperity.

rest of world

The U.S.'s balance with the outside world continued its improving trend, as the graph at right shows. After about a year of flatness, late 2011 through early 2012, the ratio of credit market debt owed to foreigners to GDP has improved for two consecutive quarters, and three of the last four. The pattern looks even better if you include net equity and foreign direct investment holdings. After years of deterioration in the foreign accounts, this stability-cum-improvement is a refreshing change.



A major reason for the improvement, as the lower graph shows, is that the foreign share of Treasury debt holdings has been stable for the last four years. And while QE might lead one to think that the Fed has just taken the place of foreigners, the graph shows that that's not really true; the central bank's share is about where it was ten years ago, and is actually lower than it was in the early 1970s. Households, though, which had stepped up their Treasury purchasing from 2009 through 2011, have stepped back.



So, deleveraging goes on, with Washington even joining in to some degree. At this point, it'd be nice to see the mortgage borrowing line break firmly above zero; a continuation of the housing recovery would feel a lot better now than extended prudence.

Thursday's retail numbers

Many have speculated that the late timing of Thanksgiving and hence its shadow, Black Friday, would lead to a weak shopping season, but history does not support that. We looked at months when Thanksgiving fell late going back to 1970, and found that between 1970 and 1991 late Thanksgivings resulted in the headline number coming in 0.5 point below the average of the previous 3 months, with a negative deviation 75% of the time, and -0.3 point and 87% for the ex-auto number.

Since the new retail series began in 1992, however, that tendency has largely disappeared. Headline deviation averages 0.1

point, and was positive 66% of the time; ex-auto, make that -0.2 point and 50% of the time (though the average is negative because of a large -2.2 point deviation in 2008 - leave that out and the average rises to +0.2); ex-auto/gas, deviation averages 0.0, though it's positive 66% of the time. The trading-day variation adjustment must take care of it now.

We're expecting November's Retail Sales headline to print at +0.6%, owing to a big jump in auto sales, with the ex-auto number coming in at +0.1%.

FOMC coda

Looking back to where employment was in August, the latest data the FOMC had before they surprised some by not advancing the taper at their September meeting, makes it pretty clear that something taperish will come out of the December meeting: nonfarm employment is up over 600,000 since August, and, on the household survey side, the number of unemployed is down about 400,000 and the number of employed up 216,000, offering some support to the 0.3 point decline in the unemployment rate. It's beyond the job description of the noisy Retail Sales report to trump that.

But the labor force itself has fallen close to 200,000 since August, dragging the participation rate down 0.2, and holding the employment/population ratio steady at August's level. This weakness in the labor detail Fed research has highlighted in recent months gives the FOMC cover, and we suspect they will make efforts to underscore their dovish stance on rates in their December statement.

—Philippa Dunne & Doug Henwood